Frontier Markets-Interview with Emre Akcakmak

Frontier Markets had a bad run this year. The MSCI Frontier index was down nearly 15 percent in 2015 and is down 5 percent so far this year. Is this a good entry point for investors?

I think what we have been seeing is an increasing disconnect between fundamentals and stock market performance. There are certainly matters to worry about but there are also good pockets of opportunities arising from the recent volatility as a majority of frontier economies continues to grow strongly and companies benefit from this. A possible reversal or even a slowdown of outflows from frontier markets could be a good catalyst given current valuations. At an expected P/E of 9.5x for 2016, frontier markets are attractively priced at 35% discount to developed and almost 15% discount to emerging markets, giving a good long term entry opportunity.

But cheap does not always mean good.

That's right. The headline P/E may be low but it may not signify a better investment opportunity. However, I think that such a large discount is unjustifiable given the superior growth dynamics of the frontier markets and higher dividend yields on top of that.

What is behind the higher earnings growth and higher dividends?

For growth, there are certainly structural reasons. Frontier markets are at very early stages of development and there is lots of room for improvement with reforms. Besides, young populations provide a brilliant base for future economic growth. Dividend yields, on the other hand, are typically higher compared to Ems, for three reasons. First, competition in the frontier markets is still not as tough as in the emerging markets because frontiers are typically at an earlier stage of development. Less competition leads to higher margins. For instance, while profit margins are 15 percent in frontier markets, those in emerging markets on average are only 7.5 percent. Second, low valuations translate into higher dividend yields even at similar payout ratios. Third, most of the frontier markets have a strong dividend culture, partially in an attempt to attract more investors to capital markets. 2015 expected dividend yields are 4.6 percent in frontier markets, 3.2 percent in emerging markets and 2.9 percent in developed markets.

Given the advantages frontier markets offer, professional investors should be heavily involved in these markets. Are they?

Institutional assets under management in emerging markets is estimated to be about 50 times higher than in frontier markets. Around USD 19bn are invested in frontier markets whereas USD 800-900bn is invested in emerging markets. Despite recent increased interest and flows, total asset under management in frontier markets is still far from motivated levels compared to GDP or population share of global economy.

Which markets do you prefer?

Before going into details of the individual markets, we look at sectors and companies to see where the best opportunities arise. Accordingly, we like companies with quality management and consumer-linked companies which benefit from the rise of the middle class in frontier markets. In terms of geography, we like Asian stocks primarily due to strong growth prospects and positive reflections of low oil prices. We also like the attractively valued Eastern European stocks in Balkans and Baltics which also benefit from the ongoing European recovery. We have lately been reducing stocks especially in the Middle East and certain parts of Africa as we think that pressures on oil and commodity prices will continue to weigh on stocks in those regions. Argentina also looks increasingly interesting as the new president Mr. Macri seems to be taking several positive steps in a bid to revive the economy.

Doesn't the effect of the low oil prices worry you?

It is for sure that oil exporters are challenged. Middle Eastern countries are under pressure but not necessarily in imminent trouble. The influence of low oil prices on Nigeria is more complicated. But there are also many beneficiaries, like Asian economies. Eastern European frontiers in the Balkans and the Baltics as well as countries like Kenya in Africa are also doing well.

To which extent your portfolio deviates from your benchmark, the MSCI Frontier Markets Index?

We have a clear overweight in consumer staples and consumer discretionary sectors which are severely missing in our benchmark. Our overall portfolio is greatly different than the benchmark index with close to 70% active share.

Do you hedge currency risks?

We pay attention to currency risks, aim for the right companies which benefit from or at least be resilient against currency fluctuations, but often don`t hedge the currency itself. With more than 20 different countries that would is typically difficult and expensive.

How big is your Fund and what are your aims?

Currently we have USD 60mn under management in our Frontier Markets Fund. That is not big for an Emerging Market Fund, but quite impressive for a frontier fund which is relatively new. The biggest Frontier Market Funds are USD 800mn to 1bn and the critical mass is typically USD 50mn.

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Emre Akcakmak, Portfolio Manager, is a Turkish national and member of the portfolio management team for Eastern Europe and Global Frontier Markets. He is based in Stockholm. Emre started at East Capital in 2006 and he is currently responsible for investments in Turkey and the Middle East and a lead manager for East Capital Frontier Markets Fund. Previously, Emre worked at the financial audit department of Deloitte & Touche and at the research department of Yatirim Finansman Securities in Turkey. He graduated from the Business Administration Department of Bosphorus University in Istanbul in 2004, then received a Swedish Institute Scholarship and finished the MSc in International Business and Economics program, with specialization in Finance, at Stockholm School of Economics in 2006. He speaks Turkish, English and Swedish and is a CFA charter holder.